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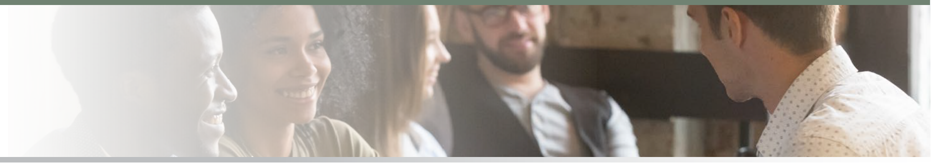

DEFINED BENEFIT PENSION PLAN

Defined Benefit/Defined Contribution Combo Plan

What is a Defined Benefit Pension Plan

A Defined Benefit Pension Plan (DB) is a qualified retirement plan. Contributions to the plan are based on a participant's age and compensation. While eligibility and distribution options are the same as other qualified plans, an actuary calculates how much a company must contribute to meet the 'benefit defined' in the plan document.

How a DB Plan Works

Based upon the employer's desired annual DB contribution, an actuary designs the plan to meet a certain benefit at retirement age. The plan accumulates the benefit through contributions and earnings. An older participant has less time until retirement, which allows for a higher contribution relative to a younger participant.

Benefits of the Owner Only DB

These plans are typically installed when an employer desires a contribution in excess of $66,000 which is the 2021 SEP IRA and Owner-Only 401(k) Plan limit ($70,000 if age 50 in the 401(k) Plan). Depending upon the employer's age and income, the allowable DB contribution could potentially reach $331,000. This amount may be increased by placing a spouse on the payroll. All contributions are a deduction to the employer and grow tax deferred. Upon plan termination, the lump sum can simply be rolled over into an IRA. At that point, IRA distribution rules would apply.

Flexibility

DB plans are much more flexible than the typical business owner might think. These plans should exist for at least 5 years with a minimal contribution of $5,000 per year, unless terminated earlier for legitimate business reasons. Proper plan design and effective funding strategies can provide owners with the flexibility they need to annually contribute their desired amount. If the investments under perform, contributions should increase and will likewise decrease if funds exceed plan expectations. Furthermore, if an owner's contribution objectives change considerably, the plan can be amended to provide the needed additional flexibility.

Turbo-Charge with Pension Protection Act

In excess of the DB plan contributions, an individual may contribute $22,500 pretax into a separate 401(k) Plan ($30,000 if over age 50). The Pension Protection Act of 2006 has now allowed for an additional 6% profit sharing contribution (maximum compensation considered is $330,000. The result is a 401(k) Profit Sharing Plan that could increase the DB contribution as much as $68,700 for example:

Owner-Only Employer	Age	Compensation	Annual DB Contribution	401(k)	6% Profit Sharing	Total
Participant	48	$70,000 W-2	$185,000	$22,500	$4,200	$211,700
Participant	60	$200,000 W-2	$272,800	$30,000	$12,000	$314,800

Impact of New Hires

If employees are hired and meet the DB eligibility, the cost may significantly increase. It is possible to redesign the DB Plan into a Combination DB/DC Carve Out or Floor Offset Plan. This would result in a 5 to 10% minimum employee contribution on a vesting schedule.

If you have questions or would like to meet with a plan consultant, please call FARMER & BETTS.